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	UTED-00	VCI-00	FRB-00	H-00	TEDE-00	INR-00	IO-00
	LAB-01	L-00	VCIE-00	NRRC-00	NSAE-00	ISN-00	NSCE-00
	OES-00	OMB-00	NIMA-00	EPAU-00	MCC-00	PM-00	GIWI-00
	MA-00	ISNE-00	SP-00	IRM-00	SSO-00	SS-00	STR-00
	TRSE-00	NCTC-00	FMP-00	CBP-00	BBG-00	EPAE-00	IIP-00
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SUBJECT: ARMENIA'S STANDING IN 2009 "DOING BUSINESS" RATINGS

REF: 2008 YEREVAN 634

SUMMARY  
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1. (SBU) Some reports on "doing business" indicators have in recent years given Armenia relatively high marks, in a few instances ranking the country on the same level as western democracies. The GOAM and potential investors have begun to pay greater attention to these ratings, as the GOAM seeks to attract foreign investment and investors attempt to assess the business environment. As was the case last year (reftel), there is considerable variation in the 2009 ratings. Most reports point to corruption as a significant and continuing problem that impedes business and economic development in Armenia, despite many recent reforms attempted by the GOAM. Some ratings remain, in our view, surprisingly high, especially since three of the eight rank Armenia ahead of Turkey -- by most measures a significantly more mature, open and transparent economy. Most also likely reflect the ideological predisposition of their sponsoring organization. End Summary.

HERITAGE FOUNDATION RATES ARMENIA HIGHEST  
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2. (SBU) The Heritage Foundation's 2009 Index of Economic Freedom gave Armenia its highest ranking among all the surveys under review. As in 2008, Heritage placed Armenia in the category of "mostly free," ranking it 31st out of 183 countries surveyed. Among neighboring countries, Georgia placed 32nd, Turkey 75th, Azerbaijan 99th, Russia 146th, and Iran 168th. Armenia ranked 18th freest among the 43 countries assessed in the Europe region.

3. (SBU) Heritage cites Armenia's main advantages as flexible and relatively simple commercial regulations, low tax rates and moderate government spending, few restrictions on foreign investment, and a wholly private and well regulated banking sector. According to the report, the freedom to start, operate, and close a business is well protected under Armenia's regulatory environment. (Comment: While Heritage gives Armenia high scores for low government spending, that is in large measure a consequence of a dysfunctional system of tax administration and systemic corruption for which it elsewhere gives the country low marks. End Comment).

4. (SBU) On the other hand, widespread corruption and weak protection of property rights reduce Armenia's overall level of economic freedom, according to Heritage. Despite numerous attempts at reform, Armenia's lowest score was in the area of corruption (30 points out of 100), which is perceived as widespread in spheres ranging from tax and customs operations to law enforcement. The report identifies burdensome bureaucratic procedures and discretionary decisions by individual officials as factors encouraging petty corruption. Heritage also criticizes the GOAM for subsidizing public transportation and public utilities, thus

distorting domestic prices. As a shortcoming, the report also mentions lack of transparency in investment regulations, and government administration that is inefficient and prone to corruption.

#### WORLD BANK: DOING BUSINESS 2010

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15. (SBU) In its Doing Business 2010 report, the World Bank and International Finance Corporation (IFC) ranked Armenia 43rd among 183 countries, seven places higher than in 2009. Georgia moved up by five places to 11th, well above neighboring countries. Azerbaijan placed 38th, Turkey 73rd and Russia 120th.

16. (SBU) Data in this report covers the period June 2008 to June 2009 and evaluates countries in 10 specific areas of business regulation. Armenia achieved its highest score (second in 2008, sixth in 2009 and fifth in 2010) for ease of registering property (on paper, it requires three procedures, takes four days, and costs 0.25 percent of the property value to register a property in Armenia). Compared to last year, Armenia also improved its positions in the areas of starting a business, cross-border trade, and obtaining construction permits. (Comment: Some of these processes work more smoothly on paper than in practice. Anecdotal evidence suggests it is still common practice for people to pay bribes to expedite construction permits. The State property registration system remains highly corrupt and dysfunctional, and if a property has any complication, it can take days of shuttling documents between offices to resolve the issue if the transacting parties are not ready to pay bribes. End Comment).

17. (U) Starting a business was made easier by the GOAM's elimination of both minimum capital requirements and a requirement to obtain approval from the national police department to prepare the company seal, as well as by making registration forms available online. Armenia strengthened access to credit information by establishing a legal framework for credit bureaus and by regulating credit information collection and the preparation of credit reports. By encouraging competition in banking, transportation and customs brokerage services, as well as by reducing the number of goods requiring inspection and streamlining the number of documents needed to clear goods, Armenia has sped trade across borders.

18. (U) Armenia's worst-performing area remains the ease of paying taxes (number 153). According to the report, an average medium-size business requires 958 person-hours annually to deal with tax issues. By comparison in Georgia it is 387 hours, in Azerbaijan 376 hours and in the USA only 187 hours.

#### FITCH RATING: ARMENIA'S CREDIT FUNDAMENTALS WEAKENED

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19. (U) Fitch Ratings downgraded Armenia's Long Term Foreign and Local Currency Issuer Default Ratings (IDRs) to "BB- with Stable Outlook," from "BB" last year. Fitch projects that Armenia's economy will contract by 15 percent in 2009 (as do, at present, the GOAM and the IMF), the third worst performance of any Fitch-rated sovereign (ahead of only Lithuania and Latvia, whose GDPs are projected to decline 16% and 18%, respectively), as remittance and investment inflows and demand for exports drop amid the global crisis. According to the report, the severity of the shock has materially weakened Armenia's credit fundamentals, warranting a downgrade. (Note: Turkey was given the same "BB- with Stable Outlook" in January 2009, though Fitch has recently indicated it may soon upgrade its rating. End Note).

110. (U) Fitch considered as main rating strengths the low level of public debt (\$1.5 billion, or 15% of GDP as of the end of 2008), although this strength will be eroded by the GOAM's accumulation of an additional \$1.5 billion in debt in the form of loans from the World Bank, IMF, Asian Development Bank and Russia to fund anti-crisis spending in 2009-2010, and the concessional nature of the debt composition. Fitch also acknowledges the high quality of Armenia's key economic policy-making institutions, praising the authorities' management of the crisis. The business environment overall compares favorably with peer countries, although Armenia's relatively poor performance in corruption indicators mars the picture.

¶11. (U) As a weakness, Fitch notes the volatility of Armenia's macroeconomic performance related to the economy's small size, narrow base, high dependence on remittance and investment inflows from Russia, low share of tax revenues as a share of GDP, and an upsurge in dollarization which has weakened the financial stability of the country.

#### PROPERTY RIGHTS ALLIANCE: WORST IN IPR PROTECTION

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¶12. (U) In its 2009 International Property Rights Index (IPRI), the Property Rights Alliance--an affiliate of Americans for Tax Reform--placed Armenia in the bottom quintile, at 98th place among 115 countries surveyed. Turkey ranked 53rd, Russia 87th, Azerbaijan 107th. The 2009 IPRI is an international comparative study that measures the protection of both physical and intellectual property rights. The study analyzes data from various sources, including the World Economic Forum, World Bank, the United States Trade Representative (USTR) Special 301 Watch List, Organization for Economic Co-operation and Development (OECD), as well as data obtained from expert surveys. The Index focuses on three areas: Legal and Political Environment, Physical Property Rights, and Intellectual Property Rights.

¶13. (U) While close to the median in terms of Physical Property Protection, Armenia is the worst performing country (115th) in terms of Intellectual Property Rights, which includes IP Rights protection, Strength of Patent Rights, and Copyright Piracy. In this ranking, Armenia shares the lowest score in any of the core components of the study with Chad (rated the last in Legal and Political Environment).

#### WORLD ECONOMIC FORUM: GLOBAL COMPETITIVENESS REPORT

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¶14. (SBU) Armenia's position in the World Economic Forum's Global Competitiveness Index was largely unchanged - Armenia ranked 97th out of 133 countries, compared to 93rd of 131 in 2008. Armenia is behind Azerbaijan (51st), Turkey (61st), Russia (63rd) and Georgia (90th). According to the report, Armenia has moved from the group of countries rated as "factor driven" to the group of "efficiency driven" countries. The index is based on 12 pillars of competitiveness, taking into account factors such as strength of institutions, quality of infrastructure, macroeconomic stability, health and education, market efficiency and size, innovation and business sophistication. In addition to publicly available data, it also uses Executive Opinion Surveys among individuals doing business in particular countries.

¶15. (SBU) As was the case last year, corruption, tax regulations, inefficient government bureaucracy and access to financing were mentioned by businessmen as the most problematic factors for doing business. Armenia's main competitive advantages remained a relatively stable macroeconomic environment (ranked 53rd) and labor market efficiency (47th). The most troubling areas include effectiveness of anti-monopoly policy (132nd), burden of customs procedures (131st), extent of market dominance (129th), intensity of local competition (128th), judicial independence (122nd), tariff barriers (119th), ease of access to loans and venture capital availability (119th and 129th), and quality of management schools (125th).

#### FAILED STATES INDEX

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¶16. (SBU) The latest Failed States Index, published by the Foreign Policy Journal in collaboration with the Fund for Peace, an independent research organization, ranked Armenia 101st in 2009, a slight improvement over its 2008 ranking (the higher the rank, the less "failed" the country is believed to be). To compile the indices, Foreign Policy Journal ranked 177 states in order from most to least at risk of failure, using 12 social, economic, political, and military indicators of state cohesion and performance, compiled through a close examination of more than 30,000 publicly available sources. The data used in each index are collected from May to December of the preceding year. Foreign Policy Journal describes Armenia as a "borderline" country. It is the only country among its

neighbors that is not considered "in danger" of state failure, with Turkey (85th), Azerbaijan (56th), Iran (38th) and Georgia (33rd), exhibiting various indications of potential failure.

¶17. (SBU) The most troubling factors for Armenia include demographic pressures, with negative population growth, an aging population, and massive deforestation from illegal logging, lack of employment opportunities, and corruption among politicians, police and the court system. (Note: The Economy and Values Research Center estimated in 2007 that over the previous decade illegal logging and illegal trade in wood was worth nearly ten times the annual legitimate harvest, generating about \$135 million in illegal revenues. End Note.) The report praises Armenia for its 2007 parliamentary elections -- calling them "free and fair" by international standards despite numerous irregularities -- and for the ability of opposition forces to hold public rallies during the campaign without police harassment. However, the report also mentions the flawed 2008 Presidential election and the police crackdown on opposition protests.

#### TRANSPARENCY INTERNATIONAL: STILL "MOSTLY CORRUPT"

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¶18. (SBU) Transparency International's 2009 Corruption Perceptions Index (based on data from 2007 and 2008) ranks Armenia 109th. The CPI ranks 180 countries by their perceived levels of public-sector corruption--as determined by expert assessments and opinion surveys--on a scale from zero (highly corrupt) to ten (highly clean). With a 2.9 score, Armenia is categorized as a "mostly corrupt" country, behind neighbors Turkey (4.6) and Georgia (3.9), but ahead of Azerbaijan (1.9), Iran (2.3), Russia (2.1), Ukraine (2.5) and Kazakhstan (2.2).

¶19. (SBU) TI's Armenian branch believes that close ties between government and business is the root cause of the problem. While Armenian authorities claim to have stepped up their fight against corruption in recent years, there is no significant decrease in the scale of corrupt practices among state officials.

#### FORBES: BEST COUNTRIES FOR BUSINESS

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¶20. (U) Forbes Magazine's annual Best Countries for Business survey ranked Armenia 94th among 127 countries, down from 63rd of 120 in ¶2008. In this rating, Armenia is outranked by Turkey (41st), Georgia (64th) and Azerbaijan (87th). The ranking uses economic data for 2008 and is based on expertise, research, and reports by a number of organizations, including Heritage Foundation, World Economic Forum, World Bank, Transparency International and Freedom House. The ranking analyzes business climate and political factors, focusing on degrees of personal freedom, level of security of investors, and corruption levels, in addition to economic policy favorable for free trade and low inflation.

¶21. (U) Armenia's worst indicators include 106th for technology, 105th for tax burden, 100th for innovation, 96th for protection of property rights, 94th for personal freedoms and 89th for corruption. According to Forbes, despite improvements made by the GOAM in tax and customs administration in recent years, anti-corruption measures will be difficult to implement. Another issue mentioned by Forbes is high unemployment rates. The disruption of rail transit into Armenia during the August 2008 Georgia-Russia conflict also highlighted how Armenia's supply chains for key goods -- such as gasoline -- are vulnerable to instances of regional instability.

#### COMMENT

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¶22. (SBU) As change in a business environment is an evolutionary process, it is not surprising that most ratings -- with the exception of the precipitous drop in the Forbes survey -- changed only slightly from last year. The surveys correctly cite continuing problems in such areas as tax, customs, property registration, protection of property rights, monopolies, and Armenia's vulnerability to political disruptions in Georgia. As most of these surveys draw from data obtained prior to the onset of the global financial crisis--which has hit Armenia especially hard--they may not adequately reflect current conditions and we would expect next

year's ratings to be somewhat lower. The GOAM will need to continue on a path of political and economic reform -- often against powerful entrenched interests -- in order to see a credible rise in its ratings and a meaningful increase in foreign investment. End Comment.

PENNINGTON